No. 90-713

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

MURRAY DRABKIN, Trustee of Auto-Train Corporation, also known as Railway Services Corporation,
Petitioner,

v.

ALEXANDER GRANT & CO., *et al.,*
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PETITION FOR A WRIT OF CERTIORARI

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Date: November 2, 1990

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QUESTIONS PRESENTED FOR REVIEW

1. Does a United States Court of Appeals nullify the long-recognized distinction between omissions of material fact and misstatements of material fact when it requires a plaintiff to prove that material facts omitted from audited financial statements "would" actually have avoided injury, rather than that proper disclosure "could" have avoided injury?

2. Does a United States Court of Appeals violate the Seventh Amendment when, in setting aside a jury verdict, rendered after a ten-week trial, the court independently reexamines the evidence of causation, credited by the jury and, based on this independent review, determines that the evidence was not "significant?"

PARTIES TO THE PROCEEDINGS

The petitioner, Murray Drabkin, is the bankruptcy trustee of the Auto Train Corporation and Railway Services Corporation, a wholly-owned subsidiary. The Auto-Train Corporation has no parent corporation and neither Auto-Train Corporation nor Railway Services Corporation has any subsidiaries that are not wholly owned.

The respondents are Alexander Grant & Co., now included in the firm Grant Thorton, and the following partners or former partners:

Joseph Abrams
Sanford L. Abrams
David H. Abramson
George E. Abs
Hugh E. Adams
Russell F. Agosta
Gerald J. Alger
James A. Anderson
John L. Archambault
Gerald S. Armstrong
Austin A. Ashley, Jr.
Theodore M. Asner
Kenneth W. Banet
George Y. Banks II
W. Dawson Baptist
Barry Barber
Robert T. Barnard
Stanley R. Baseman
Daniel R. Bauer
Ronald C. Baum
Vernon J. Baus
William C. Beisenstein
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Benny W. Bender
Robert L. Berge
Ronald Berman
James E. Blakeney
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Peter L. Bower
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Steven A. Braun
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Merlin E. Breunig
Charles L. Brezak
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James R. Burns
Richard L. Burton
Joel L. Burzin
Louis C. Buschle
Allen A. Butcher
Paul J. Carleton, Jr.
Robert H. Carroll
Francis J. Cascio
David J. Charles

Melvin Chernow
Norman T.S. Chong
Howard Cohen
Lawrence M. Cohen
Jack L. Collins
Joseph P. Conlon, Jr.
Owen J. Cooney
Donald H. Cormie
Kenneth W. Couch
Charles I. Covey
Paul N. Crossland
James H. Dale
Billy Joe Day
Edwin W. Decordova
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Francis J. Dobrowski
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Walter E. Erwin, Jr.
Robert A. Esernio
Domenick Esposito
Norman M. Essman
Charles R. Fallon
Louis A. Fanchi
Stanley E. Feldman
Burton K. Fischer
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Wesley R. Fitzpatrick
Fred S. Flegel
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Geoffrey K. Flynn
J. Cloyd Fox
Christian P. Frederiksen
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Robert V. Garcia
Thomas F. Geary
Kent J. Gedman
John W. Geerling
John T. Gillespie
Richard S. Glassman
John M. Goldberger
Morton D. Goldman
Arthur M. Goldrich
Arnold J. Goldstein
Barry J. Goldstein
Alan M. Goldstine
Jose L. Gomez
Aubrey E. Gomillion
J. Lowell Goode
Richard Gordimer
Stanley Graber
Tom R. Gray III
Frank Greenberg
Ronald Greenberg
Fred J. Griffin
Thomas H. Gregory
Gary N. Grosenick
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Randall D. Hadley
Joseph J. Haith
William J. Hajjar
Claude H. Hamilton, Jr.
Claude M. Hamrick, Jr.

James P. Hayden
Milford N. Hedberg, Jr.
James R. Herman
Robert M. Hersh
Elmer Heupel
James S. Hickey
J. Roger Holmstrom
Alex B. Hossack
William F. Howard
Robert F. Huber
Lynn F. Hurdelbrink
Minoru Ted Inouye
Richard D. Jacobson
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Richard A. Knight
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Jerald J. Newbrough
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Leroy R. Norby
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Ray H. Odom, Jr.
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John J. O'Leary
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A. George Palmer, Jr.
John A. Parrish
Thomas C. Parsons
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Alan D. Paul
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Johnnie E. Pearson
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John S. Quinn
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Thomas T. Ueno
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J. Malcolm Visbal
Stanton H. Vollman
Edward J. Vonderbrink
John Walsh
Thomas C. Walters
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James E. Watts
Barry D. Weiss
David M. Wendt
Dale C. Wesley
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James L. Zegar
Ronald R. Zideck
Patrick D. Zorsch

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ALEXANDER GRANT & CO., *et al.*,
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PETITION FOR A WRIT OF CERTIORARI

Petitioner Murray Drabkin, Trustee of Auto-Train Corporation, also known as Railway Services Corporation, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered herein.

OPINIONS BELOW

The opinion of the court of appeals is reproduced in the appendix to this petition at App. 1a-9a and is reported at 905 F.2d 453. The order of the district court denying the motion for judgment notwithstanding the verdict is reproduced at App. 10a. The verdict form returned by the jury is reproduced at App. 11a-13a.

JURISDICTION

The judgment of the court of appeals was entered on June 15, 1990. An order denying petitioner's timely request for rehearing was entered on August 6, 1990. This Court has jurisdiction pursuant to 28 U.S.C. 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

The Seventh Amendment to the United States Constitution provides,

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

STATEMENT OF THE CASE

Review is sought in this case because the new standard of proof announced by the court of appeals for omissions cases would, if allowed to stand, substantially hinder efforts to hold accounting firms responsible for injuries to institutions caused in connection with the national savings and loan crisis. It would, as well, hinder governmental and private efforts to enforce the federal securities laws. Review is also sought because the court of appeals' new formula for independent reexamination of facts and inferences therefrom decided by a jury runs directly afoul of the Seventh Amendment and conflicts with the decisions of this Court, including the decision in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986). The Court should review and correct the stated standard of review in order to preserve the integrity of the Seventh Amendment.

A. Facts

The trustee in bankruptcy of the Auto-Train Corporation ("Auto-Train") commenced this action against the company's independent auditor, Alexander Grant & Co. ("Grant"), to obtain redress for defects in the 1977,

1978, and 1979 audits of Auto-Train and the 1980 audit of Railway Services Corporation, a wholly-owned subsidiary.[1] The trial lasted ten weeks. It included the testimony of 20 witnesses and over 350 exhibits. The jury of nine returned a special verdict form which awarded the trustee damages of $5.0 million for the 1978 audit, awarded him damages of $6.0 million for the 1979 audit, found no liability with respect to the 1977 and 1980 audits, denied the trustee's request for punitive damages, and awarded Grant unpaid fees for the period April to September 1980.[2] App. 11a-12a. The trial judge thereafter denied Grant's motion for judgment notwithstanding the verdict. App. 10a.

The evidence supporting the jury's findings of breach of contract, negligence, and fraud in 1978 and 1979, included the following:

- Grant failed to require disclosure that, commencing in 1978, Auto-Train diverted to its own operations the funds withheld from employees' paychecks for payment of state and federal taxes and the employer contributions for railroad retirement taxes. By the end of 1979, the tax delinquency had grown to $2.4 million.

- The Grant partner in charge of the audits testified that the diversion of tax funds was not disclosed because "we had the problem of where do we stop disclosing payables that were overdue."

- Grant failed to detect and require disclosure of the fact that Auto-Train's railroad cars, which, at approximately $16.0 million, were the largest asset on the balance sheet, included a hodgepodge of rusted, unpainted, or cannibalized hulks providing shelter for the homeless in a field in Florida or

[1] Jurisdiction in the United States District Court was based on 28 U.S.C. § 1334.

[2] The jury had nine members because the parties agreed to let the alternates participate in the deliberations.

serving simply as storage bins. Almost half the cars were not in use and had no reasonable likelihood of use.

- Grant failed to discover and require disclosure that Auto-Train's repair parts and supplies inventory, carried on the financial statements as a $2.0 million asset, consisted largely of unused and unusable items. Grant tested spare parts use only by observation of dust accumulations, instead of by reference to readily available and fully informative inventory records maintained by Auto-Train.

B. Injury to Auto-Train

The jury heard testimony from George Green, one of Auto-Train's outside directors, that knowledge of the information omitted from the 1978 and 1979 financial statements would have altered dramatically his conduct as a director and would have altered, as well, the course of Auto-Train's activities. Green was an experienced businessman, who served on a number of corporate boards. He also possessed thorough knowledge of the railroad industry by virtue of his employment as President of Pullman Standard Company. Green Tr. 3159-63.

In essence, Green testified that (1) he was not aware of the information omitted from the financial statements, (2) had he known, he would have been unalterably opposed to operating on tax funds, (3) the omitted information evidenced a company in a much more severe economic crisis than the company portrayed in the audited financial statements, (4) had he been made aware of the magnitude of the crisis by properly prepared financial statements, he and the outside directors could have caused Auto-Train to institute a rigorous rehabilitation program, and (5) if rehabilitation were not feasible, protection under the Bankruptcy Code could have been sought. Like Green, the other outside directors were also unaware of the true magnitude of Auto-Train's problems.

The fiscal bleeding which continued under the unchecked leadership of management injured Auto-Train in several ways. Most significantly, Auto-Train continued to erode its net worth by incurring liabilities which it could not pay. At the time of bankruptcy in 1980, the liabilities were approximately $25 million. Assets were of minimal value. By contrast, Auto-Train showed a positive net worth of $1.1 million as of December 31, 1978.

C. The Decision Below

The court of appeals reversed the jury's verdict and reversed, as well, the decision of the trial judge not to grant a motion for judgment notwithstanding the verdict. In casting aside the views of the jury and the judge who heard the evidence, the appellate panel did not challenge the jury's findings of breach of contract, negligence, and fraud. Rather, the panel determined that Grant's proven breach of professional standards, no matter how great, did not cause Auto-Train any injury. In making this finding, the panel discounted the evidence of causation introduced by the trustee, including the testimony of Green, because it did not prove that injury "would" have been avoided. App. 3a, 5a-7a. In addition, the panel claimed the right to independently reexamine the evidence and to find it not "significantly probative," even though the jury had found it credible and probative. App. 8a-9a. Citing the scant authority of a 1956 law review article entitled "Ruminations on Cause-In-Fact," the panel announced a new standard of review: Appellate judges may involve themselves "in some gauging of probabilities . . . at the extremes." App. 9a.

REASONS FOR ALLOWANCE OF THE WRIT

I. THE STANDARD OF PROOF OF CAUSATION IMPOSED BY THE COURT OF APPEALS CONFLICTS WITH PRIOR DECISIONS OF THIS COURT CONCERNING THE EFFECTS OF OMISSIONS AND WILL GREATLY INCREASE THE BURDENS OF BOTH FEDERAL REGULATORY AGENCIES AND PRIVATE CLAIMANTS

The teaching of this Court's decision in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986), is that, when assessing whether genuine issues of fact for decision by a jury exist, the applicable substantive evidentiary standard must be taken into account. 477 U.S. at 255. Thus, where, as here, causation in fact is the critical issue, "it is peculiarly a question for the jury." *Prosser and Keeton on the Law of Torts* § 41, at 265 (5th ed. 1984).[3]

More importantly, where, as here, liability is predicated on omissions, the plaintiff need not prove that timely disclosure would have caused a different outcome to have occurred. Rather, the plaintiff need only prove that a different outcome could have occurred. *See Daniels v. Hadley Memorial Hospital*, 566 F.2d 749, 757 (D.C. Cir. 1977); *Hicks v. United States*, 368 F.2d 626, 632 (4th Cir. 1966). As stated by this Court, in an omission case under Rule 10b-5,

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor *might* have considered them important in the making of this decision. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.

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[3] "It is a matter on which lay opinion is quite as competent as that of the most experienced courts." *Prosser and Keeton*, § 41, at 264.

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 152, 153-54 (1972) (citations omitted; emphasis added); *see Mills v. Electric Auto-Lite Company*, 396 U.S. 375, 384 (1980).

The panel imposed a far greater burden on the trustee. It required proof that proper accountancy "would have averted . . . the harms alleged." App. 3a. The panel expressly criticized Green's testimony for being in the contingent "could" form. App. 6a-7a.

The standard of proof imposed by the panel is not only incorrect, but ironically the trustee's efforts to elicit from Green what he "would" have done were cut off by objection from Grant. *See* Joint Appendix in Court of Appeals ("J.A.") 1078-1112. Thus, Grant requested, and the court of appeals provided, a reversal of the jury's verdict due to the absence of evidence which Grant itself prevented from being introduced. This further buttresses the conclusion that the wrong standard of proof was applied.

The court of appeals' new standard of proof for omissions cases, if allowed to stand, will seriously thwart federal regulatory efforts. Resolution Trust Corporation and Federal Deposit Insurance Corporation lawyers are, at this moment, actively seeking to recover from accounting firms damages for losses sustained from the collapse of federally insured savings and loan associations, savings banks, and commercial banks. The causes of action asserted in the bank failure cases are virtually identical to those asserted by the trustee against Grant. Enforcement efforts of the Securities and Exchange Commission and private individuals under both the 1933 and 1934 securities acts also involve similar claims.

The standard of proof announced below will seriously curb those efforts. Indeed, we can be sure that every major accounting firm in the United States has placed a copy of the decision below in its defensive arsenal and stands

ready to invoke it against the next government or private party who brings suit. This Court should not permit a judicially created hindrance to such important remedial and law enforcement efforts to go unreviewed.

The panel decision appears to have been motivated by the belief that accountants should not be insurers against business failures. App. 8a. Whatever the merit of that proposition, it must certainly be true that professionals who breach their obligations should not be shielded from accountability by the cleverness of their lawyers and by intrusive legal formulations impinging on jury discretion. This is especially so where what is at stake is the ability of the judicial system to determine the responsibility of that profession for injury to the American people of unprecedented proportions. These potential ramifications more than justify review in this case.

II. THE COURT OF APPEALS INDEPENDENTLY WEIGHED THE EVIDENCE AND REJECTED A LEGITIMATE INFERENCE IN DEROGATION OF THE SEVENTH AMENDMENT AND CONTRARY TO PRIOR DECISIONS OF THIS COURT

The Seventh Amendment to the United States Constitution states that "no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law." As recently explained by this Court, the Seventh Amendment precludes precisely the weighing of evidence engaged in by the panel:

> Credibility determinations, the weighing of evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge, whether he is ruling on a motion for summary judgment or for a directed verdict. The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor.

Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986); *see Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines,*

Ltd., 369 U.S. 355 (1962); *Lumbermen's Mutual Casualty Co. v. Elbert,* 348 U.S. 48 (1954).

The panel identified a single passage from outside director Green's testimony as constituting the trustee's evidence of causation. Even that evidence, standing alone, should, under these basic principles, have placed the issue of causation squarely in the province of the jury. *See* App. 5a. Green stated that, with proper disclosure, he and his fellow board members could have acted differently. This permitted the jury to infer that proper disclosures in the financial statements audited by Grant could have averted some of the ensuing $25 million in losses.

But worse, the panel simply ignored—indeed, denied —such additional testimony by Green as the following:

> I think that is one of the—that was cause for alarm. . . .
>
> Because if you're delinquent on your payroll taxes and using that money to finance the operation of the company, you are in real serious trouble, because you're using money that belonged to employees to finance that company and I think that's a very, very serious thing when you start playing games with the government.

J.A. 1073.

The panel also failed to mention Green's credentials. They were, as the jury heard, impeccable. *See* this Petition, at 4, *supra*.

Apart from disregarding much of Green's testimony, the panel also ignored substantial additional evidence of causation in the trial record:

- Carl Kampel, the trustee's expert witness, testified that the disclosures which Grant allowed to be omitted from the financial statements were material, that the going concern qualifications were not a qualitative substitute for the omitted information, and that, accordingly, proper disclosures

should have prompted a strong response from anyone reading the financial statements. J.A. 1016-17, 1023; 20 Tr. 3037-38.

- Elmer Mathews, a senior revenue officer for the IRS, testified that Auto-Train had no right to use employee trust funds, that the consequences of using such funds were severe, and that he was under direct orders to collect every nickel owed by Auto-Train. J.A. 785-86, 805-06; 6 Tr. 658-59, 675, 773-74.

- Grant's own expert witness, Marvin Stone, stated that in 1978 and 1979 management could have still turned the company around. J.A. 1183-84.

- Under section 6672(a) of title 26, United States Code, directors may be held personally liable for a corporation's unpaid withholding taxes. The jury was made aware of this statute, and Green expressly stated that the potential for personal liability was a reason why he would never tolerate the use of trust funds to meet operating expenses. J.A. 1073, 1076.[4]

The foregoing evidence, in conjunction with the underlying evidence of breach of contract, negligence, and fraud, provided a substantial basis for a reasonable juror to make the inference that fully informed outside directors would have steered Auto-Train on a dramatically different course. Indeed, it is virtually inconceivable that outside directors would allow Auto-Train's officers to finance company operations with tax trust funds once they became aware of the practice. While officer-directors, desperate to save their jobs, might resort to this, outside directors would have nothing to gain but personal liability. There is nothing implausible about the inference—clearly drawn by the jury—that deprivation of the trust funds would have forced substantial operating changes

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[4] Green succinctly observed, "As a director, all of us were liable." J.A. 1076.

at Auto-Train as early as 1978. Use of these funds was all that kept the company out of bankruptcy for two years.

The jury also justifiably inferred that proper disclosure of the startling reductions in the values of rolling stock and spare parts would have forced dramatic change. As Grant's opinions themselves noted, borrowing against Auto-Train's asset base was essential to its survival.

The panel discounted the probative value of the trustee's proof—that is, weighed the evidence—by a recitation which closely mirrored Grant's closing argument to the jury. For example, the panel asserted that, since only Green testified about the alternative measures that the directors could have taken, there was no evidence about what the other outside directors would have done. This simply ignores the wholly logical inference that the other outside directors, like Green, would have taken all action necessary to avoid the potential for personal liability. Similar testimony from other directors would merely have been cumulative. If anything, Green's testimony shifted to Grant the burden of eliciting contrary evidence from the other directors, and the jury was entitled to draw an adverse inference from Grant's failure to do so.

The panel also placed great reliance, as did Grant's trial counsel, on the Board of Directors' meeting of August 18, 1980, the first meeting after the outside directors learned of the tax problem. Rather than weakening the trustee's case, this meeting further evidences the efforts of Grant and management to conceal facts from the outside directors and the public. The evidence before the jury clearly demonstrated that, during this meeting, Grant, and the inside directors, misled the outside directors into believing that the tax problem had been resolved, when, in fact, it had not. Moreover, the meeting occurred a scant two weeks before bankruptcy. As Green concisely explained his reaction at the meeting, "[T]he horse was out of the barn then." J.A. 1077. The jury certainly

could, and apparently did, accept this view of the meeting's significance.

The panel uncritically embraced the centerpiece of Grant's defense—the going concern qualifications in the opinions. While the panel characterized the trustee's attack on the qualifications as merely quantitative, App. 4a-5a, the trustee's thrust was much sharper. He proved that the "warnings" were substantively deficient. The qualifications, as written, merely state that the company would need to obtain additional financing. J.A. 114, 225. Both the 1978 and 1979 qualifications uncritically accept entrenched management's optimistic prediction that financing would be obtained "in the near future." J.A. 127-28, 234.

Nowhere do Grant's opinions suggest that the IRS could shut the company down at any moment, that the directors are incurring personal liability, or that the asset base to support new financings was dramatically overstated. Indeed, even the panel's almost off-hand statement that lack of new financing precipitated Auto-Train's bankruptcy, App. 7a, resolves a hotly contested issue of fact against the trustee. The objective facts are that the IRS froze all of Auto-Train's bank accounts on the morning of September 8, and the bankruptcy petition was hurriedly filed that same afternoon.

Finally, the panel argued that the going concern qualifications directly undercut the trustee's case as to overvaluation of assets, because the qualifications warn that the full value of the assets might not be realized. App. 8a. What the going concern qualifications, of course, meant is that, if the company ceased to operate, the liquidation value of the assets would be less than the book value. The trustee's case, however, was that, due to disuse and decay, many of the assets carried at full value in the financial statements already were in the equivalent of a liquidation state. Since new financing depended greatly on the value of Auto-Train's assets as collateral,

this question was of major significance. That the panel which threw out the jury's work could be so wide of the mark on this fundamental accounting issue—fully covered in the trial record—is as good an illustration as any of why the Seventh Amendment prohibits appellate courts from reexamining facts.

Effectively conceding that it is breaking new ground, the panel asserts the right to determine whether evidence supporting a verdict "establish[es] the minimum necessary probability . . . ." App. 6a. This becomes a "gauging of probabilities . . . at the extremes." App. 9a. Precisely where the "extremes" end and the sacrosanct core of jury discretion begins, the panel never explains. Certainly, as applied in this case, the asserted line of demarcation has no meaningful existence. This is especially so when the panel failed to "view the evidence presented through the prism of the substantive evidentiary burden" on the plaintiff in an omissions case, as commanded by *Anderson v. Liberty Lobby*, 477 U.S. at 254. The panel has carved out a new evidentiary territory into which judges may now tread, territory previously thought restricted to jurors.

Notably, the only support which the panel can muster for its right to "gauge probabilities" is a 1956 article in the Stanford Law Review, entitled "Ruminations on Cause-In-Fact." App. 9a. The panel's inability to provide any meaningful authority for its actions underscores dramatically the extent to which the decision departs from precedent. Jury verdicts are not to be set aside on the basis of misconceptions about 35-year old academic ruminations.

CONCLUSION

For the reasons stated above, the writ of certiorari should be allowed.

Respectfully submitted,

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Date: November 2, 1990

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued February 20, 1990 Decided June 15, 1990

No. 89-7087

MURRAY DRABKIN, TRUSTEE, AUTO-TRAIN CORPORATION,
A/K/A RAILWAY SERVICES CORPORATION,
Appellee

v.

ALEXANDER GRANT & COMPANY, *et al.*,
Appellants

Appeal from the United States District Court
for the District of Columbia

Kathryn A. Oberly, with whom *Patricia A. McCoy*, *David B. Isbell* and *James C. McKay* were on the brief, for appellants. *Kenneth S. Geller* also entered an appearance for appellants.

John J. Walsh, with whom *Mark C. Ellenberg* was on the brief, for appellee.

Before: WILLIAMS, *Circuit Judge*, ROBINSON and TIMBERS*, *Senior Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* WILLIAMS.

WILLIAMS, *Circuit Judge*: Alexander Grant & Co., an accounting firm, appeals the trial court's refusal to overturn an $11 million jury verdict for negligence, fraud, and breach of contract in the preparation of auditing statements for Auto-Train, a corporation that later de-

* Of the United States Court of Appeals for the Second Circuit, sitting by designation pursuant to 28 U.S.C. § 294(d).

clared bankruptcy. We reverse, finding no evidence of a causal relation between the accountant's failures and the client's damages.

* * * *

Auto-Train was a promising idea that went sour. During ten years of operation, beginning in 1971, the company carried passengers and their cars between Lorton, Virginia (near Washington, D.C.) and Sanford, Florida (near Orlando). Those who travelled by Auto-Train saved either the trouble of driving to Florida or the expense of flying and renting a car on arrival. This attraction apparently worked well enough until 1976, the company's first year in the red. It never recovered, filing for bankruptcy in September 1980. Eight months later the trains stopped rolling. Liabilities were in the neighborhood of $25 million and assets "minimal."

Grant served as Auto-Train's independent outside auditor. The bankrupt's trustee claimed various deficiencies in Grant's annual audits of company financial statements for the years 1976 to 1979, and in a (pre-bankruptcy) 1980 opinion on that of a subsidiary. The most significant was Grant's failure to make a specific note of Auto-Train's failure to pass on to the IRS payroll taxes withheld from employees; instead of doing so on a timely basis, Auto-Train used these funds to meet its own cash needs. The trustee also claimed that Grant grossly overstated the value of Auto-Train's rolling-stock and spare parts inventory; the correct figures would have made Auto-Train's disastrous financial statements appear still more calamitous. The trustee contrasts the $1.2 million in proceeds for liquidation of rolling stock with the $18 million figure at which it was carried on the financial statements.

As to both defects, the trustee argued that proper disclosure by Grant would have prompted an alert among the company's directors at a time when corrective action was still possible. At the very least, says the trustee, the company would have filed for bankruptcy protection earlier

than it did, thus saving millions in liabilities needlessly accumulated in the doomed effort to keep Auto-Train running. At trial the trustee asked for $25 million in damages (roughly the bankrupt's entire negative net worth) on theories of fraud, negligence, and breach of contract. By special verdict, the jury gave him $11 million, finding Grant liable on all three theories, but only for the 1978 and 1979 audits. The trial court denied Grant's motion for judgment notwithstanding the verdict, and Grant appeals.

* * * *

Although the parties feud a good deal over concepts of legal causation, this is not a case that turns on refinements of those concepts. In the trustee's two theories of harm—i.e., of rescue obstructed or liquidation deferred—the principle is that accurate audits would have prompted company action to cure or mitigate the company's basic economic problems. Under each theory, Grant's omissions are characterized as a discrete link in a chain of causation. Thus the facts do not fall within the limited class of cases where courts relieve the plaintiff of the minimal duty of showing "but for" causation—cases where multiple independent causes (e.g., a fire caused by negligence and one of unknown origin), each capable of bringing about a loss, operate coincidentally. See W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* 266-67 (5th ed. 1984). Accordingly, the trial court here was required to grant the defendant's motion for judgment n.o.v. if no reasonable person could find it more probable than not that correct accountancy would have averted either of the harms alleged. See, e.g., *Waugh v. Suburban Club Ginger Ale Co.*, 167 F.2d 758 (D.C. Cir. 1948); see also *Cotton v. Buckeye Gas Products Co.*, 840 F.2d 935, 937 (D.C. Cir. 1988) (reviewing federal and District of Columbia standards for grant of directed verdict or judgment n.o.v.). This sort of causal link is necessary regardless of whether the defendant failed some test of professional care, and it applies to all three theories of recovery.

It is undisputed, of course, that Grant was not responsible for the underlying cause of Auto-Train's failure. As a result of recurrent derailments caused by braking failures, Auto-Train had to shorten the length of its trains and increase its fares at the same time that the airlines were discounting theirs. See Joint Appendix ("J.A.") 186-87 ("Management's Discussion and Analysis of Summary of Operations" for 1979). Bad luck both at the company itself and in its market, and perhaps bad management, brought about the losses. Grant's place on the causal chain consists simply of its alleged failure to raise the alarm.

But Grant had raised the alarm. Its audits hardly painted a rosy picture of Auto-Train's financial condition. For the years for which Grant was found liable, 1978 and 1979, they showed losses of $4.4 million and $2.8 million, respectively—no cause for celebration or even complacence. For both of those years, moreover, Grant issued what are known in accounting shorthand as "going concern" qualifications, raising the possibility that the subject of the audit will *not* keep "going" and warning that in the event of a shutdown the balance-sheet asset valuations would *not* be fully realized. See J.A. 114, 128 (qualifications to Grant's 1978 financial statement); J.A. 225, 234 (for 1979); see generally *Copy-Data Systems, Inc. v. Toshiba America, Inc.*, 755 F.2d 293, 299 & n.2 (2nd Cir. 1985); *Devaney v. Chester*, 1989 U.S. Dist. LEXIS 4986, slip op. at 4 (S.D.N.Y. 1989). Issuing a going concern opinion may not insulate an accounting firm from liability, cf. *Bradford-White Corp. v. Ernst & Whinney*, 1987 U.S. Dist. LEXIS 7879, slip op. at 36-37 (E.D. Pa. 1987), *aff'd in part, rev'd in part*, 872 F.2d 1153 (3rd Cir. 1989), but it must cut strongly in its favor. See *In re North American Acceptance Corp. Securities Cases*, 513 F. Supp. 608, 636 n.15 (N.D. Ga. 1981) (calling "going concern" qualification "about the most conspicuous 'red flag' that an auditor can wave"). As Auto-Train's condition was so grimly

depicted, the trustee is reduced to claiming that the alarm wasn't raised loudly enough, that another decibel or two would have made all the difference.

The trustee nonetheless advances a scenario, hinging on the role of Auto-Train's outside (i.e., non-management) directors, in which Grant appears as the key villain. He contends that these directors, who filled four of seven spots on the company's board (three of six after a vacancy was created by resignation in 1979), did not know of the tax or valuation problems, and that if they had known, they would have either taken necessary corrective action to restore the company's financial health or put it immediately into receivership, thus cutting off the accrual of its eventual $25 million in net liabilities.

For this the trustee relies on the litigative equivalent of a sound bite in the midst of a ten-week trial. Only one outside director, George L. Green, gave any indication at trial that awareness of the payroll tax problem might have spurred him on to decisive action, or indeed to any action at all. If Grant's audit had specified the delinquency, Green testified on direct examination,

> A: As a director, I could have insisted that management reduce expenses, reduce overhead, eliminate things that could have waited to accumulate payments, monies, so that we could liquidate that obligation on the payroll taxes . . . . If that did not succeed, I would strongly recommend, because of the fact that that monies [sic] were being used to finance the company and we could not raise the capital, then I think my position would have been that—
>
> The Court: Well, what action could you have taken is the question.
>
> A: I could have recommended filing for bankruptcy.

J.A. 1113-14.

We assume the jury could reasonably have credited this statement. But compare *Devaney*, slip op. at 14 ("[v]ague, self-serving, speculative testimony concerning what a party would have done under different circumstances is generally not admissible"); *Matter of Hawaii Corp.*, 567 F. Supp. 609, 627 (D. Hawaii 1983) (in bench trial court discounts as "unreliable" testimony of board members who approved a reorganization that later bombed and who then claimed that more accurate accountant's statements would have turned their votes). Even so, plaintiff has failed to establish the minimum necessary probability that Grant's omissions materially prolonged Auto-Train's decline. See *Chase v. Gilbert*, 499 A.2d 1203, 1212 (D.C. 1985).

No one seriously questions that the inside directors, though well enough aware of the problem (perhaps even its source), stood by silently and passively. As for the outside directors other than Green, none even so much as speculated as to how he might have responded to the tax revelation. Indeed, only one of them, Jerald Jarrard, testified with any certainty that he was ignorant of the tax delinquency despite Grant's omission, J.A. 1124, while conceding that he "didn't have to read the annual report" to know that the company was "in pretty sad shape." J.A. 1188. The trustee's case is thus reduced to the assertion of one director (Green) that but for Grant's omission he would have insisted on things one would expect a director of a desperate company to have been pushing for in any case (e.g., reduce expenses) or, failing that, "have recommended" filing for bankruptcy.

The trial judge recognized the necessarily speculative character of Green's own testimony, and indeed for that reason insisted that it be framed in the highly contingent form of saying that he "*could*" do this or that, rather than that he would have. See J.A. 1104-13. But the weakness of the testimony goes further. Green's role as a *single* director limited his ability to effect a rescue or

pull the plug. Action would have required the support of the three other outside board members (assuming support from their management colleagues unlikely, given their knowledge, passivity, and possible connivance). There is no evidence that Green could have persuaded them that immediate bankruptcy was the right response to the tax delinquency. In *Day v. Avery*, 548 F.2d 1018 (D.C. Cir. 1976), we discounted a somewhat comparable claim. A law partner claimed injury from the firm executive committee's falsely asserting that no partner would be worse off as a result of a merger; in fact the merger triggered a coup removing Day as head of a branch office. He claimed that in not opposing the merger he had relied on the committee's promise. The court found that reliance immaterial to the final decision to merge, as "appellant's vote was not necessary to effect the merger nor sufficient to defeat it," *id.* at 1028, and upheld sumary judgment for the partnership.

Of course it might seem easier for Green to have rallied the outside directors around a company rescue than for Day to have rallied his partners to his personal cause. But in fact we know here what *actually* happened when the tax specifics *did* become known: nothing. In August 1980 an article in *The Washington Post* revealed the unpaid tax liability, and an audit committee meeting, with Green and one other outside director in attendance, broached the subject. The directors did not swing into immediate action, but rather were quite content with an assurance that the IRS was not about to seize assets to satisfy the deficiency—and with, at the same time, renewing Grant's contract as auditor. See J.A. 347 (audit committee minutes); J.A. 1098-99 (Green testimony); Reply Brief of Appellant 11 n.15. The company's eventual bankruptcy was in fact prompted not by the tax problem, but by its failure to secure continued financing. See J.A. 1205 (testimony of Auto-Train CEO Eugene Garfield).

The trustee's case is even weaker with respect to the alleged overvaluation of the company's assets. On that score the going concern qualifications were explicit, warning that a "*major* portion of the assets reflected in the accompanying balance sheets is dependent upon the Company's ability to meet its financing requirements, to maintain present financing, and the success of its future operations." J.A. 128 (for 1978); J.A. 234 (for 1979) (emphasis added). It also seems evident that the outside directors had some idea of the state of the idle equipment; at a June 1979 board meeting, one quizzed management as to the condition of the company's rolling stock, expressing concern over its "appearance and maintenance." J.A. 681. See *Devaney*, supra, slip op. at 12-13 (no causation where plaintiff had knowledge of facts it claimed another should have provided). Nothing appears on the other side of the balance. No one, not even Green, professed ignorance of potential problems with the asset valuations (assuming Grant to have been in some way derelict with respect to them), much less that enlightenment would have ushered in a new regime.

* * * *

We are of course hesitant to nullify a jury's findings of fact. See *Prosser and Keeton on Torts* 264-65. But the jury's primacy as factfinder cannot exempt it from the bounds of reasonableness. A defendant who is clearly not responsible for a harm should not have to pay for it. Cf. *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 685 (7th Cir. 1990) ("[d]efrauders are a bad lot and should be punished, but Rule 10b-5 does not make them insurers against national economic calamities"); *DiLeo v. Ernst & Young*, No. 89-2027, slip op. at 8 (7th Cir. May 7, 1990) (unwarranted extension of accountant liability would reduce investor information as increase in cost of accountancy services would diminish quantity purchased). The court submits to the jury only those issues on which the party with the burden of proof offers "significantly probative" evidence. See *Richardson v. Richardson-Merrell*,

Inc., 857 F.2d 823, 829 (D.C. Cir. 1988). The trustee's case fails at this threshold. This judicial screening undoubtedly involves the court in some gauging of probabilities, but only at the extremes. See Wex S. Malone, *Ruminations on Cause-In-Fact*, 9 Stan. L. Rev. 60, 68-72 (1956). Performance of the task is an essential backstop to judicial definition of the law; if courts' endorsement of verdicts is automatic, the law, however sound, can simply drift off into irrelevance as juries do their will.

Finding no significant evidentiary foundation for the jury's finding of liability, we reverse.

So ordered.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 83-0580 JGP

MURRAY DRABKIN, Trustee,
Plaintiff

v.

ALEXANDER GRANT & COMPANY, *et al.*,
Defendants

ORDER

This comes before the Court on the defendants' Motion For Judgment Notwithstanding The Verdict Or In The Alternative For a New Trial Or Remittitur. The motion is opposed by the plaintiff. After giving careful consideration to the motion, the opposition thereto and the record in this case, the Court concludes that the motion should be denied.

It is hereby

ORDERED that defendants' motion for judgment notwithstanding the verdict or in the alternative for new trial or remittitur is denied.

/s/ John Garrett Penn
JOHN GARRETT PENN
United Startes District Judge

Feb. 16, 1989

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 83-0580

MURRAY DRABKIN, Trustee of Auto-Train Corporation, also known as Railway Services Corporation,
Plaintiff

v.

ALEXANDER GRANT & COMPANY, *et al.*,
Defendants

VERDICT SHEET

[Filed July 16, 1985]

1. Do you find that Alexander Grant breached its contracts to perform services for Auto-Train or Railway Services for the following years:

For the 1977 audit of Auto-Train

Yes No ✓

For the 1978 audit of Auto-Train

Yes ✓ No

For the 1979 audit of Auto-Train

Yes ✓ No

For the 1980 audit of Railway Services

Yes No ✓

2. Do you find that Alexander Grant performed services in a negligent manner in connection with the audits for the following years:

For the 1977 audit of Auto-Train

Yes No ✓

For the 1978 audit of Auto-Train

Yes ✓ No

For the 1979 audit of Auto-Train

Yes ✓ No

For the 1980 audit of Railway Services

Yes No ✓

3. Do you find that Alexander Grant committed fraud in connection with the audits for the following years:

For the 1977 audit of Auto-Train

Yes No ✓

For the 1978 audit of Auto-Train

Yes ✓ No

For the 1979 audit of Auto-Train

Yes ✓ No

For the 1980 audit of Railway Services

Yes No ✓

4. If you answered "Yes" to any of the above questions, state the amount of compensatory damages that you award to plaintiff for applicable year (enter the total amount for each year):

For 1977 —0—

For 1978 5,000,000.00

For 1979 6,000,000.00

For 1980 —0—

Total award for all years 11,000,000.00

5. Do you find that Alexander Grant is liable for punitive damages?

Yes No ✓

6. If your answer to question number 5 is "Yes", state the amount of punitive damages that you award the plaintiff:

Punitive damages ——————

7. Do you find that Alexander Grant is entitled to recover from Auto-Train and Railway Services fees incurred by Alexander Grant for services performed by that firm during the period April 1980 through September 1980?

Yes ✓ No

/s/ Mrs. Sarah M. Davis
Foreperson

Date 7/16/85

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 89-7087

September Term, 1989
C.A. 83-0580

MURRAY DRABKIN, Trustee of Auto-Train corp.,
a/k/a Railway Services Corporation

v.

ALEXANDER GRANT & COMPANY, *et al.*,
Appellants

BEFORE: Williams, Circuit Judge, and Robinson and Timbers *, Senior Circuit Judges

ORDER

[Filed Aug. 6, 1990]

Upon consideration of appellee's petition for rehearing, filed July 13, 1990, it is

ORDERED, by the Court, that the petition is denied.

Per Curiam

FOR THE COURT:
CONSTANCE L. DUPRE
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

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* Of the United States Court of Appeals for the Second Circuit, sitting by designation pursuant to 28 U.S.C. § 294(d).